

DIRECT TESTIMONY

OF

DIANNA HATHHORN

ACCOUNTING DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

AMERITECH ILLINOIS

DOCKET Nos. 98-0252/98-0335 (CONSOL.)

NOVEMBER 3, 2000

Witness and Exhibit/Schedule Identification

Q. Please state your name and business address.

A. My name is Dianna Hathhorn. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. By whom are you employed and in what capacity?

A. I am an Accountant in the Accounting Department of the Financial Analysis Division of the Illinois Commerce Commission.

Q. What is the function of the Accounting Department of the Illinois Commerce Commission?

A. The Department's function is to monitor the financial condition of public utilities as part of the Commission's responsibilities under Article IV of the Public Utilities Act and to provide accounting expertise on matters before the Commission.

Q. Please describe your background and professional affiliation.

22 A. I am a licensed Certified Public Accountant. I earned a B.S. in Accounting
23 from Illinois State University in 1993. Prior to joining the Commission in
24 1998, I worked as an internal auditor for another Illinois state agency for
25 approximately 3.5 years. I also have 1.5 years experience in public
26 accounting for a national firm.

27

28 **Q. Have you previously testified before this Commission?**

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30 A. Yes, I have.

31

32 **Q. What are your responsibilities in this case?**

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34 A. The Director of the Accounting Department of the Illinois Commerce
35 Commission assigned me to this case and defined the scope of my
36 responsibilities. In this proceeding, my responsibilities include reviewing
37 Illinois Bell Telephone Company's ("Ameritech Illinois" or "AI" or "Company")
38 filing, analyzing the underlying data and proposing adjustments when
39 appropriate.

40

41 **Q. What is the purpose of your testimony in this proceeding?**

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43 A. The purpose of my testimony is to propose adjustments to the Company's
44 operating statement and rate base concerning merger-related planning and
45 implementation costs, plant under construction, and pension settlement
46 gains. These adjustments are used in the computation of the revenue
47 requirement in Staff Exhibit 5.0. My adjustments to AI's operating income
48 are included in Staff Exhibit 5.0, Schedule 5.02. My adjustments to rate base
49 are included in Staff Exhibit 5.0, Schedule 5.04.

50

51 **Q. Are you sponsoring any schedules as part of Staff Exhibit 6.0?**

52

53 A. Yes. I prepared, or supervised the preparation of, the following schedules for
54 the Company, which show data as of, or for the test year ending December
55 31, 1999:

56 Schedule 6.01 - Adjustment to Merger Planning and Implementation
57 Costs

58

59 Schedule 6.02 - Adjustment to Plant Under Construction

60 Schedule 6.03 - Adjustment to Pension Settlement Gains

61

62 Merger Planning and Implementation Costs

63 **Q. Please describe Staff Exhibit 6.0, Schedule 6.01, Adjustment to**
64 **Merger Planning and Implementation Costs.**

65

66 A. Schedule 6.01 presents my proposed adjustment to operating income to
67 disallow costs billed from SBC Communications Inc. ("SBC") to AI related to
68 planning and implementation of the SBC/AI merger. These costs are
69 included in the Company's "Prior Period" adjustment on Ameritech Illinois
70 Exhibit 7.0, Schedule 1, Column (B). Such costs were a one-time, non-
71 recurring expense of the merger between AI and SBC, and therefore need to
72 be excluded from the revenue requirement in order to present a normal, on-
73 going level of expenses for the future. The merger was approved by the
74 Commission in Docket No. 98-0555, Original Order dated September 23,
75 1999 ("Original Order"), with an Amendatory Order entered November 15,
76 1999 ("Amendatory Order").

77
78 **Q. Are there any other reasons for your adjustment?**

79
80 A. These costs may affect the 50% Net Merger-Related Savings condition from
81 the Original Order, at p. 262, Finding 8, which states:

82 "[T]he provisions of Section 7-204(c) are being applied
83 to the reorganization, so that 50% of the net merger-
84 related savings as previously defined herein, allocable
85 to Illinois, are to be allocated to the merged company's
86 customers in accordance with the determination set
87 forth in the prefatory portion of this Order."

88
89 In the Original Order, at page 149, the Commission required AI to track its
90 share of all actual merger-related savings and all merger-related costs, so

that the net merger-related savings can flow-through AI's annual price cap filings. These merger-related savings and costs are currently under audit, as also directed by the Commission in the Original Order, p.149. Therefore, the merger costs on my Schedule 6.01, presented by AI as merger planning and implementation costs, are more appropriately addressed in the context of this Commission-ordered audit. Additionally, many of the planning and implementation costs presented by AI in Data Request DLH-005, for this proceeding, included items such as legal fees, travel, and meals expenditures. These costs appear to meet the definition of "transactional costs" which were specifically to be excluded from recovery, according to the Amendatory Order, p. 7. Since transactional costs are barred from rate recovery, it would be inconsistent with the Amendatory Order to include them in the Company's cost of service.

Plant Under Construction

Q. Please describe Staff Exhibit 6.0, Schedule 6.02, Adjustment to Plant Under Construction.

A. Schedule 6.02 presents my proposed adjustment to rate base to reflect the Plant Under Construction account at a 13-month average balance, as shown on Schedule 6.02 line 1, rather than at the 12/31/99 year-end balance that the Company used, reflected on Schedule 6.02 line 2. The basis for my

adjustment is that since the 12/31/99 year-end balance is greater than any other month from December 1998 through November 1999, an average is necessary to reflect an amount more representative of an entire year. Use of the average also smooths out monthly fluctuations in the account balance.

Pension Settlement Gains

Q. Please describe Staff Exhibit 6.0, Schedule 6.03, Adjustment to Pension Settlement Gains.

A. Schedule 6.03 presents my proposed adjustment to operating expenses to reflect a normalized level of pension settlement gains in the test year.

Q. Has the Company defined the term “settlement gain” as it is used in this adjustment?

A. Yes, in its response to Staff data request DLH-030, the Company defined a pension settlement gain as,

“[A]n irrevocable transaction that relieves the employer of primary responsibility for a pension benefit obligation and eliminates significant risks related to the obligations and the assets used to effect the settlement. A lump sum cash payment to plan participants in exchange for their rights to receive specified pension benefits is an example of a pension plan settlement.”

Q. Has the Company included settlement gains in Ameritech Illinois Exhibit 7.0, Schedule 1?

A. No, the Company has removed the entire 1999 settlement gain from AI's revenue requirement, as part of its "Prior Period" adjustment on Ameritech Exhibit 7.0, Schedule 1, Column (B). The Company stated that since the gain was a result of an abnormal work force loss, which is not a normal operations occurrence, it was eliminated from the revenue requirement (Company response to Staff data request DLH-032).

Q. In your opinion, is this the correct regulatory manner in which to treat the 1999 settlement gain?

A. No. First, an amount needs to be recognized in the revenue requirement to reflect the normal, recurring level of settlement gains usually experienced by the Company. I have calculated this amount on my Schedule 6.03, page 2 of 2, from the Company's response to Staff data request DLH-040. This response showed that the Company has experienced pension settlement gains every year, beginning in 1991. Therefore, it is clear that settlement gains do recur, and as such, should be reflected in the revenue requirement.

159 Second, a decision must be made as to the treatment of the amount of gain
160 resulting from the abnormal force loss in 1999. I have calculated this amount
161 at line 8 on page 1 of 2 of my Schedule 6.03, by deducting the average
162 annual settlement gain from the total 1999 gain. The Company has
163 demonstrated that, compared to the historical gains of 1991 through 1998,
164 the 1999 settlement gain is definitely an unusually large amount. However
165 this does not negate the fact that the ratepayers have previously funded
166 100% of the Company's pension expense. Therefore, ratepayers deserve
167 full recovery of the benefit of any gains reflected in the Company's pension
168 fund. Because of this, I recommend the abnormal gain be recognized in the
169 revenue requirement and be amortized over five years. Five years is the life
170 of the current alternative regulation plan and, therefore, a reasonable
171 estimate of the time interval between rate cases for the Company. If the
172 Commission changes the life of the new plan to a period other than five
173 years, I recommend that the amortization period be consistent with the new
174 plan's life, and I recommend changing my adjustment to pension settlement
175 gains accordingly.

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177 **Q. Does this conclude your prepared direct testimony?**

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179 **A.** Yes, it does.